

Quigley John M

**From:** O'Donnell Douglas W </O=INTERNAL REVENUE SERVICE/OU=WASHINGTON DC/CN=RECIPIENTS/CN=T3DCB> on behalf of O'Donnell Douglas W  
**Sent:** Monday, December 7, 2015 3:57 AM  
**To:** Pam Olson (US - TAX)  
**Subject:** RE: draft of remarks

Hi Pam,

Thanks for sharing - I appreciate your perspective. I presume you are OK if I share this with some of my team after you have delivered your remarks.

Best,

Doug

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**From:** Pam Olson (US - TAX) [mailto: ]  
**Sent:** Sunday, December 06, 2015 11:06 PM  
**To:** O'Donnell Douglas W  
**Subject:** draft of remarks

(b)(6)

Doug - Thanks for the time on Friday. I created this as a google doc and didn't know whether you'd be able to open it so I copied and pasted my draft remarks below. No need to read this if you don't have time. Thanks again. Pam

Speech to NY TEI  
12/7/15  
The LB&I Reorganization  
What Is It and What's in It for Me?

What is the LB&I reorg?

In case you haven't heard, the IRS is currently grappling with a significant shortage of funds and a Congress that is unwilling to appropriate more. Indeed, Congress has been in a mood in recent years to cut resources for the IRS, leaving it in a difficult spot. As late Commissioner Don Alexander used to observe, tax collectors have never been popular, going all the way back to biblical times. Add a measure of partisanship over some egregious errors in judgment, and the picture gets much worse. It doesn't matter to Congress that the errors were committed by a small part of the organization responsible for administration of an area having nothing to do with the agency's core mission.

That said, it is essential that the agency find ways to increase its efficiency. The task would be easier if Congress would stop saddling them with non-mission critical responsibilities - the ACA, for example.

But let me ask you -  
How many of you are learning to do more with less?

Are your budgets ever cut without a corresponding reduction in what you have to do?

Are your budgets always increased to reflect additional responsibilities?

Could you tell your boss, if you give me less, I'm going to do less?

I don't intend to be critical of the Commissioner who assumed a difficult job and has done it well, but here's the thing. Saying that "if you give us less, we're going to do less" may have helped with sagging IRS employee morale, but ultimately, it fails to inspire. More important, it hasn't worked with Congress. It's time to retire the line.

And that's where the LB&I reorganization comes in.

In certain respects, the LB&I reorganization is like every IRS reorganization you've ever witnessed. There are boxes moving around an org chart, with jobs eliminated and jobs created.

You may be hearing from your teams and their managers about this part of the reorganization. Why? Because it's personal. It's about jobs. Who loses one? Who gets one? Where will they work? How will they work? How will their routines change?

What sets this reorganization apart from every other reorganization, however, is that it's about more than the boxes on an org chart, how they're labeled, and who occupies them.

And that's the important part of the LB&I reorganization. Once implemented, it will fundamentally change the way LB&I operates. In my view, for the better.

Let's consider the current operation. A distinction is drawn between the largest companies and everyone else. The largest roughly 1000 companies - the CIC taxpayers - have been audited year in and year out. Why? Because they're big. Not because they've been found to be noncompliant or because large adjustments have been found and sustained or because new risks turn up year after year, but because even minor proposed adjustments can appear to produce large amounts of additional tax. The adjustments may turn around quickly in subsequent years because they are only timing issues but that doesn't affect the way the dollars are counted.

Of the next roughly 100,000 companies - the IC taxpayers - approximately 10% are pulled for audit on the basis of compliance scores, prioritized, sent to the field, and worked as resources permit. (How does the compliance scoring work, you ask? I don't know. While I was at Treasury, I was briefed on changes to the scoring of returns in Small Business and Self-Employed - but only at a high level. When I asked a question requiring a more detailed explanation, I got the standard CIA line: they could tell me, but then they'd have to kill me!)

Whether it's the CIC or IC taxpayer, there is a fundamental similarity in that the revenue agent or team assigned to the case is in control of deciding what issues to audit, what resources to devote, and how to do the audit. This is where the most significant LB&I reorg change comes in. Once implemented, the LB&I reorg will no longer provide 100% coverage on CIC taxpayers and will no longer vest decision-making about what to audit with the revenue agent or team.

Instead, decisions would be made at a "corporate" level - that is, on a nationally centralized, coordinated basis - of what to audit, which will in turn determine which returns to audit.

To those of us in the private sector whose daily activities are dictated by the priorities set by our organizations, our bosses, our bosses' bosses, the board, there is nothing surprising about this. Indeed, it's hard to imagine operating otherwise. None of us is allowed to freelance. But this is a sea change for the IRS which has relied on the capacity of agents to discover the issues that matter, one return at a time.

What are the obstacles to success? There are several. Let's go through a few.

**Independence.** Revenue agents have been independent, fiercely so, to guard against the possibility of inappropriate meddling in the audit of a return. The independence stems from scandals that occurred over 60 years ago. The transparency that is common today make them highly unlikely to recur. In addition, the fears of inappropriate intervention which led to independence being the most valued characteristic were overblown in my view - based on my over 30 years in and out of government. In any event, to succeed, the revenue agent's definition of independence will have to change. Decisions about resources and how to spend them will be decided on a coordinated, centralized basis. Agents will still be expected to exercise independent judgment and will not have blinders on.

I think the coordination and centralization is a very good thing. I recall times from my government days when revenue agents made decisions to pursue penalties which precluded the audit of returns with the same deficiencies. Result: one taxpayer paid additional tax *plus penalty* while another taxpayer escaped without adjustment. Balance is needed and that can only be provided on a coordinated, centralized basis.

**Issue identification.** In the reorganized LB&I, the compliance program will depend on LB&I's ability to ferret out the issues requiring attention without individual revenue agents and teams going through returns one at a time. How will this happen? Anyone remember Secretary Rumsfeld's line about known unknowns and unknown unknowns?

Over the years, many means have been developed to highlight the key issues on large business tax returns. There is coordinated disclosure by businesses and their advisors in addition to Schedules M and UTP. In addition, there are many sources of public information outside of the return. Audited financial statements and other public filings. Press coverage. Whistle blowers. Academic studies. NGOs and think tanks.

In short, it won't be easy but clues abound. LB&I has to devote its resources to determining how to mine and use them.

**Campaigns.** Another novel part of the LB&I reorganization is the recognition that auditing returns and proposing adjustments is only one way to improve compliance. To that end, LB&I contemplates employing different mechanisms - under the rubric of campaigns - to improve compliance with respect to the issues identified. The issues could be audited. They could be the subject of an industry issue resolution or other form of published guidance. They could give rise to proposals to change the law. They could be approached indirectly via a third party. Or they could be addressed through something entirely different. Disclosure, for example. In my view, the disclosure that has been added over the last couple of decades represents a significant way in which the IRS has positively affected compliance. Disclosure brought sunlight. Sunlight has altered behavior. Altered behavior means fewer issues to audit.

**Culture.** The IRS is charged with enforcing the law. When it comes to the tax law, I don't like the word "enforcement." I dislike it so much that I fought former Commissioner Everson over his desire to call one of his deputies the deputy for "enforcement". Let's remember that the agency is the Internal Revenue **Service**. The IRS does so much more than enforce. It administers. It interprets. It advises. It collects. Yes, it enforces, but enforcement is a last resort, and the tactics associated with it are best reserved for those who choose not to comply. If enforcement becomes the dominant characteristic, the agency loses its balance in dealing with the public, the vast majority of whom need service to assist them in voluntarily meeting their tax obligations, not enforcement.

**Distrust and suspicion.** The relationship between business and the IRS is too often marked by distrust and suspicion. This is a two way street. With or without LB&I's reorganization, administration of the tax law would be improved if there were a conscious effort to be transparent, speak openly, understand opposing points of view, and work together to resolve issues.

**Collaboration.** The government benefits significantly from what it learns from external sources. The fact of the matter is that we all do. In the networked world in which we operate, a decision not to collaborate is a decision

to fail. Use the crowdsourcing concept we hear so much about today as a metaphor. My partner who leads the NY Metro practice tells of the difference between two new hires, one of whom has a network and the confidence to use it and the other of whom does not and is afraid to ask for help. Given the same assignment, when the project is due, the first turns in a product that has had the benefits of input from the network - a template, a precedent, a model, a spreadsheet, a shortcut, a similar experience - that results in a polished work product. It has, in effect, been crowdsourced. The second turns in a product that reflects what the new hire has been able to figure out alone. The first turns in a top quality work product. The second turns in a product that needs work. Fear, distrust, and suspicion are impediments to collaboration, but collaboration is essential to more effective and efficient tax administration.

**Making use of the 80-20 rule.** There is a rule of thumb that 80% of you-name-it comes from 20% of the effort to generate you-name-it. For example, 80% of a company's sales come from 20% of its products. That doesn't mean the remainder deserves no attention, but it does suggest how resources should be allocated. Moving towards a compliance system that operates on the basis of identifying issues before an audit begins and focusing the audit on those issues represents a dramatic embrace of a reallocation of resources to problem areas. The result should be more effective audits.

**Clarity of vision.** The essential ideas behind the reorganization will require considerable effort to rethink many of the programs and procedures currently in place. In the meantime, operational decisions are being made, some of which, at least at the surface, are hard to align with the logic of the reorganization. For example, what happens with CAP? For now, we understand that CAP will remain in place; however, companies that had been working towards admission to CAP in 2016 have been advised that they will not be admitted. Companies that are part of CAP understandably want to preserve the program and the certainty sooner that it brings. For many companies, CAP has not meant a reduction in resources, though the process is much more efficient because it is current and focused on resolution of issues rather than raising issues as is often the case with the normal audit process. I understand the same is true of the IRS's resources. If the IRS intends to allocate resources more effectively, then I believe it must consider more radical steps. If CAP taxpayers represent the most compliant companies, why not move all of them into CAP maintenance and replace them with the new applicants? Or if the new applicants have earned a place in CAP, perhaps they, too, should be moved directly to CAP maintenance.

**Changing the rewards system.** From the perspective of the business community, I think it is safe to say that many would like to see a system that rewards IRS employees for the behaviors that foster a more effective and efficient tax system. Taxpayers often feel that they are held to a very high standard but they see limited consequences for the IRS's failure to live up to similar expectations.

**Other obstacles.** The press, politics, well-intended do-gooders, opponents of change, any and all of them could make the implementation of the reorganization more challenging. Whatever decisions LB&I makes on how or what to audit is certain to be questioned, doubly so when stories emerge, as they are certain to, about instances of noncompliance. It won't matter that compliance has been improved in other areas or that the noncompliance would have been missed even if LB&I had not reorganized and had continued to strive for compliance by auditing one return at a time. LB&I has to be prepared for that kind of response. So does the business community because the real target of a complaint will be the business community's noncompliance, not the IRS's failure to eliminate it.

What's in the reorganization for business taxpayers? If successful, the reorganization should end the perpetual soup-to-nuts audits of large corporate taxpayers and replace it with audit plans that focus on genuine issues. This is a challenging undertaking, and I think LB&I will need a lot of help. Specifically, our help. TEI's help. The help of companies, trade associations, and professional organizations who understand the vital role of tax administration and who understand that we can change things for the better if we work together.

Those of us who deal with IRS audits on a regular basis can easily tick off a number of problems with the audit process. In the view of many taxpayers, IRS audits have become increasingly inefficient and unmanageable. Many of the problems observed in the audit process are the same obstacles to the success of the reorganization:

- Lack of centralized management, accountability, and transparency
- Inconsistencies and rigidity in the execution of the new IDR process
- Use of litigation tactics that send what should be a cooperative undertaking south

Done well, the reorganization of LB&I should result in more efficient and effective audits for both the IRS and taxpayers. I believe the key to improved tax administration and the success of the LB&I reorganization will be the ability of LB&I and taxpayers to work together. It has been a number of years since the last meaningful collaboration between taxpayers and the IRS on the design of the audit process. It is time to launch that process again. To that end, a coalition of trade associations, supported by the corporate community and working with TEI, has put together a website - [eetax.org](http://eetax.org) - for effective and efficient tax administration - that sets out the challenges, catalogs the current impediments to effective and efficient audits, and begins to propose options to address them. The items on the webpage reflect the current audit process, but they are a useful compendium of the problems that must be addressed as LB&I transitions to the reorganization. One of the next steps will be trying to build a mechanism for crowdsourcing of an improved audit process.

Will the LB&I reorganization succeed? I believe it will because I believe it must for a simple reason. We will never return to a world with sufficient resources to achieve tax compliance one return at a time.

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[redacted] (b)(6)

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